No. 216

Supreme Court of the United States

OCTOBER TERM, 1940

COMMISSIONERS OF THE SINKING FUND OF THE CITY OF LOUISVILLE,

Petitioner,

v.

A. M. ANDERSON, Receiver of the National Bank of Kentucky, and NATIONAL BANK OF KENTUCKY,

Respondents.

BRIEF IN OPPOSITION TO PETITION FOR WRIT OF CERTIORARI

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STATEMENT OF THE CASE

The National Bank of Kentucky is insolvent and respondent A. M. Anderson is the receiver duly appointed by the Comptroller of the Currency.

The petitioner, the Commissioners of the Sinking Fund of the City of Louisville, is a corporation created and exist-

ing under and by virtue of Sections 3010-1 to 3024, inclusive, of the Kentucky Statutes.[1]

The City of Louisville is a separate and distinct corporation, and it receives its powers by separate legislation. The statutes which create the corporation known as "Commissioners of the Sinking Fund of the City of Louisville" do not deal with the city itself.

When the bank closed the Commissioners of the Sinking Fund of the City of Louisville (hereinafter called Sinking Fund Corporation) had a balance on deposit of $858,952.48. This balance was divided into the following accounts:

General Fund Account	$166,275.99
Sewer Bonds 1907 Issue	58,930.91
Sewer Bonds 1920 Issue	140,220.56
School Bonds 1922 Issue	84,954.71
Memorial Bonds 1924 Issue	27,018.56
Sewer Bonds 1925 Issue	127,632.08
Grade Crossing Bonds	138,489.18
Sewer Bonds 1929 Issue	46,116.40
Hospital Bonds	41,002.36
Louisville Water Co. 1906 Issue	14,135.73
Louisville Water Co. 1910 Issue	14,176.00
	$858,952.48

At that time the National Bank of Kentucky held in its portfolio the following securities, all of which were bond obligations of the City of Louisville:

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[1] Section 3010-1, Carroll's Kentucky Statutes reads:

"Sinking fund; commissioners; number and election.—The sinking fund to pay the bonded debt of the city is hereby continued as now established by law, and shall consist of the mayor, the president of the board of aldermen for the time being, and three persons to be chosen on joint ballot, as hereinafter directed, and they and their successors in office shall continue to constitute the 'commissioners of the sinking fund of the city of Louisville,' and by that name shall continue to have corporate powers and existence, may sue and be sued, and do and perform all things necessary to execute the duties required and powers given them by this act."

City of Louisville, 3½% 1903 Issue, maturity 1943	$ 14,000.00
City of Louisville Hospital, 4½% 1911 Issue, maturity 1951	20,000.00
City of Louisville, Refunding, 3½% 1901 Issue, maturity 1941	13,000.00
City of Louisville, Refunding, 3½% 1901 Issue, J. D., maturity 1941	53,000.00
City of Louisville, School Improvement Bonds, 5% 1922 Issue, maturity	5,200.00
City of Louisville, School, 4½% 1914 Issue, maturity 1954	10,000.00
City of Louisville, Sewer, 4% 1907 Issue, maturity 1947	25,000.00
City of Louisville, Sewer and Park, 3% 1901 Issue, maturity 1941	29,000.00
	$169,200.00

All of these bonds with one exception were pledged to the United States Government as collateral security for government deposits of postal savings funds. After the appointment of the receiver the bonds were redeemed by the payment of $58,057.71 from the general assets in his possession (R., Vol. II, 91). The bonds were selling above par and during the pendency of these proceedings they were sold for $173,512.25 or $4,312.25 in excess of their face amount (R., Vol. I, 40).

The bonds were carried in the investment ledger of the bank, the carrying value in some cases was below par and in others above par (R., Vol. II, 44-6). None of the bonds was purchased from the Sinking Fund Corporation or from the City of Louisville. They were all acquired in 1919 when the National Bank of Kentucky merged with the National Bank of Commerce (R., Vol. II, 44).

Each of the bonds contained a statement that "the City of Louisville for value received hereby promises to pay . . ." (R., Vol. II, 91-3).

It will be noted that the promise is only by the City of Louisville. There is no promise by the separate and distinct corporation known as "Commissioners of the Sinking Fund of the City of Louisville."

Shortly after the bank closed a dividend of 67% was paid to creditors (R., Vol. I, 92). Since this case was tried in the District Court an additional 10% dividend has been paid.

In the petition filed by the Sinking Fund Corporation claim was made for a preference to the full extent of the deposit and in the alternative the plaintiff prayed for an order requiring the Receiver to deliver the bonds to the Sinking Fund Corporation subject to a credit on the deposit of their face amount, $169,200.00.

The alternative demand was designated by the Sinking Fund Corporation as a "claim of setoff" and on that basis it attempted to obtain the bonds. The relief sought was denied and the present petition for writ of certiorari is addressed solely to the demand of the Sinking Fund Corporation for delivery of the bonds.

The prayer in the petitioner's bill of complaint reads (R., Vol. I, 14):

> "(1) For a judgment against the defendant, Paul C. Keyes, as Receiver of the National Bank of Kentucky, that the plaintiff is entitled to offset its account in the National Bank of Kentucky to the extent of One Hundred and Sixty-nine Thousand and Two Hundred Dollars ($169,200.00), of City of Louisville Bonds mentioned in the petition, that said offset be made as of the date of the closing of said Bank and *that said Keyes, as such Receiver, be ordered and directed to deliver to this plaintiff said One Hundred and Sixty-nine Thousand and Two Hundred Dollars ($169,200.00) City of Louisville Bonds* with interest coupons attached as of the date of said offset and if said interest coupons have been cashed, to deliver to this plaintiff the full amount of same in cash."[2]

[2] Emphasis throughout this brief ours unless noted otherwise.

ARGUMENT

No Ground for Allowance of the Petition for Writ of Certiorari Has Been Advanced by the Sinking Fund Corporation

Petitioner predicates its argument for allowance of the writ of certiorari on the assumption that the relief sought was a setoff of mutual accounts. Proceeding on this erroneous assumption it asserts that rulings of this court and decisions in other circuits have been disregarded.

However, the Court of Appeals did not depart from the well settled rules of setoff since no problem of setoff was presented under the facts. The court dismissed as irrelevant the cases relating to setoff relied upon by petitioner.

There are no special or important reasons presented by petitioner to justify the granting of certiorari. The case is unique, involving circumstances not likely to arise again, and of no general public interest.

Petitioner Seeks a Forced Sale to It of Assets of the Bank, Selling Above Par, at Their Face Value, the Consideration Therefor to be Cancellation of an Equal Amount of Its Deposit. A Forced Sale of Such Character Cannot Be Effected by Calling It an Alleged "Setoff"

Generally when a setoff is requested a situation is presented where parties have mutual claims and the court balances one claim against the other, cancelling them to this extent and allowing a claim to the extent of the balance due. No such balancing of mutual accounts for the purpose of determining the actual obligation was requested or desired by the Sinking Fund Corporation. It prayed for an order directing the receiver

> "to deliver to this plaintiff said $169,200.00 City of Louisville bonds with interest coupons attached."

The bonds were not to be cancelled. They were to continue as obligations of the City of Louisville. If the relief

desired had been granted the Sinking Fund Corporation could hold the bonds as assets of the Sinking Fund, collect interest thereon for that fund or sell the bonds on the market for any price obtainable. At the time of the closing of the bank the bonds were worth in excess of their face value and if the relief sought had been granted then the Sinking Fund Corporation would have acquired the bonds with its depreciated deposit and it could have sold them for an amount in excess of their face value. The Sinking Fund Corporation would not only secure payment of its deposit in full but it would also profit out of the failure of the bank to the extent of the amount realized on the sale of the bonds in excess of their face value. The Sinking Fund Corporation did not seek to cancel mutual obligations but attempted to use its deposit in the bank to invest in securities. During the pendency of these proceedings the bonds were sold for \$173,512.25, or \$4,312.25 in excess of their face amount. If the Sinking Fund Corporation had been successful in requiring the receiver to deliver the bond it would have realized this profit of \$4,312.25.

The \$169,200.00 on deposit, which the Sinking Fund Corporation desired to set off against the bonds, was only worth \$113,364.00 at the time the bank closed. This is based on the fact that the receiver was then paying a 67% dividend. Under the petitioner's claim the Sinking Fund Corporation could use this deposit worth \$113,364.00 to acquire investments which had a face value of \$169,200.00 and an actual value of \$173,512.25. The Sinking Fund Corporation would not only have received a preference but would have benefited as a result of the failure of the bank while other depositors were only receiving 67% of their deposits.

A depositor is not permitted to benefit by exercising the right of setoff. This is illustrated by the rule that an endorser of a note may only set off his obligation against his deposit when the maker of the note is insolvent. No setoff

is permitted when the maker is solvent since "such a result would be inequitable." *Willing* v. *Binenstock*, 302 U. S. 272, 276, quoting from *Bank of United States* v. *Braverman*, 259 N. Y. 65, 71, 181 N. E. 50.

If the Sinking Fund Corporation had received the same bonds as a pledge for the repayment of its deposit, assuming such pledge was proper, and if the pledged assets had been sold after the bank closed, the Sinking Fund Corporation would only be permitted to retain so much of the sale price as would pay off its deposit. The excess would go to the receiver for the benefit of the depositors. Under the relief sought by the petitioner, however, it would not only have the benefit of a pledge which never existed but it would become possible for the petitioner to profit to the extent of the excess value of the bonds over the face amount.

In pointing out that setoff was not involved, the court of appeals said (R., Vol. II, 136):

> "We are of the opinion not only that the Commissioners have no right to a setoff, but that they have not, in reality, asserted such a right. What they have sought is a forced sale to them of the City's unmatured bonds, selling above par, at their face value, the consideration therefor being cancellation of an equal amount of the insolvent Bank's indebtedness. The right of setoff involves only a cancellation of mutual indebtedness. Cf. *Scammon* v. *Kimball*, 92 U. S. 362."

The Relief Sought Was Properly Denied Because the Bonds Were Pledged at the Time of the Closing of the Bank

Petitioner's counsel conceded in the lower court that there would be no right of setoff had the bonds remained pledged. He contended, however, that such right of setoff was created by virtue of the redemption of the securities by the receiver after the bank closed. This is a claim that a right of setoff which did not exist as of time of insolvency

could be created by subsequent action of the receiver. The rights of all parties were fixed when the bank closed. The right of setoff being governed by the state of things existing at the moment of insolvency (*U. S. Fidelity & Guaranty Co.* v. *Wooldridge*, 268 U. S. 324), subsequent events cannot create a right of setoff which did not exist at the time of failure.

The decision in *Ellerbe* v. *Studebaker Corporation of America*, 21 F. (2d) 993 (C. C. A. 4, 1927), relied upon by petitioner, is clearly distinguishable from this case on the facts, and in any event is not in conformity to the principles laid down by Mr. Justice Holmes speaking for this court in the *Wooldridge* case, *surpa.*

If the argument of the petitioner is correct the depositors of the bank would have been in a better position if the receiver had permitted the U. S. Government to sell the bonds and apply the proceeds on the postal savings fund deposit. It is conceded that if this procedure had been taken there would be no setoff. Rights cannot be gained as a result of errors of the receiver [*U. S. Shipping Board et al.* v. *Rhodes*, 297 U. S. 383; *La Parr* v. *City of Rockford, Ill.*, 100 Fed. (2d) 564; *Granzow* v. *Village of Lyons, Ill.*, 89 Fed. (2d) 83], and his use of depositors' money to redeem the bonds cannot create a right of setoff which did not exist when the bank closed and would never have existed if the receiver had required the government to exercise its rights under the pledge arrangement to recover its deposit.

> "Had they (the bonds) not been redeemed, the Commissioners would never have contended that they were entitled to them. The receiver has re-acquired them with money that was a part of the bank's general assets, and we think they should, in consequence, bear the character of general assets. Morever, we think, as did the receiver, that any claim the Commissioners may have as to these bonds must have existed when the

bank failed; they can acquire no right as a result of the receiver's decision to redeem the bonds instead of allowing the government to sell them to satisfy the bank's debt." (Opinion Court of Appeals, R., Vol. II, 136.)

The Sinking Fund Corporation Has No Right to Mature the Bonds and There Are No Mutual Obligations to Cancel

The Court of Appeals concluded that "the right of setoff involves only a cancellation of mutual indebtedness." Petitioner neither prayed for cancellation of the bonds nor was in a position to cancel them. The bonds were unmatured. Petitioner relied on Section 3010-9, Carroll's Kentucky Statutes, as authority for accelerating the maturity date. The section reads in part:

> "The said Commissioners shall apply said fund to the payment of the city's debts chargeable on the same, when they can do so on fair terms; but whenever there shall be a surplus of said fund, which cannot be applied on fair terms to the extinguishment of said liabilities, the said commissioners may invest the same in bonds of said city, or for which it is bound. . . ."

Since the Sinking Fund Corporation was asking for delivery of the bonds and not their cancellation it was not attempting to apply the funds in the payment of the city's debts. It was attempting to acquire securities which would continue to be outstanding obligations. The city would still be liable for interest. The purchaser would be in a position where it could sell the bonds when it was advantageous to do so. This certainly is not an acceleration of the maturity date. It is not striking a balance between parties having mutual obligations. Setoff does not permit one party to acquire a salable investment which can be used by that party to profit at the expense of the depositors of the bank.

The right of the petitioner to accelerate the bonds is limited by statute and by the ordinances under which the bonds were issued. The ordinances provide that the Sinking Fund Corporation should collect a special tax for payment of the bonds which,

> "shall be set apart by the Commissioners of the Sinking Fund of the City of Louisville and safely invested so as to yield interest, and the sinking fund arising therefrom shall be preserved and used alone for the payment of the principal of said bonds at maturity." (R. Vol. II, 74.)

The Sinking Fund Corporation cannot pay the bonds prior to maturity.[3]

The Relief Sought Was Properly Denied Because Acquisition of Bonds by the National Bank of Kentucky and Deposit of Funds by the Sinking Fund Corporation Were Two Wholly Independent Transactions and Were Not Brought Into Mutual Account by Any Agreement of the Parties

The bonds were acquired by the bank in 1919. Petitioner did not know that the bank owned the bonds. Therefore its deposits were made without reliance on the bank's ownership of these bonds as a means of payment of the account. The fact that the acquisition of the bonds by the bank and the deposits by the Sinking Fund Corporation were wholly unrelated is a bar to setoff even if setoff had been prayed for. *Scott* v. *Armstrong*, 146 U. S. 499, 507; *U. S. Fidelity & Guaranty Co.* v. *Wooldridge*, 268 U. S. 234.

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[3] See Ordinance 198 covering the issuance of the $29,000.00 worth of bonds in 1901, pursuant to ordinance adopted in 1900 (R., Vol. II, 73). Ordinances as to the other issues containing similar language appear in the record (R., Vol. II, 75-90).

The Relief Sought Was Properly Denied Because the Bonds Are Obligations of the City of Louisville and the Funds Belong to the Commissioners of the Sinking Fund of the City of Louisville, a Separate Corporation

Each of the bonds was an obligation of the City of Louisville. They were not obligations of the Sinking Fund Corporation. The deposits belong to the petitioner. Under the statutes of Kentucky the funds of the two corporations were separately deposited.[4]

Deposits by the Sinking Fund Corporation are covered by Section 3010-12, Carroll's Kentucky Statutes.[5]

The relationship between the two corporations can be compared to the relation between a parent and subsidiary corporation. Obligations of a subsidiary corporation cannot be offset against deposits of the parent corporation and vice versa. *General Discount Corporation* v. *First National Bank-Detroit*, 5 Fed. Supp. 709 (1933).

Even when a sinking fund is under the direct management of the city treasurer and not separately incorporated, a deposit of sinking fund money is recognized as distinct and independent from general funds of the city and other special deposit accounts. Thus in *Federal Deposit Insurance Corporation* v. *Casady*, 106 F. (2d) 784 (C. C. A. 10, 1939), the court held the Federal Deposit Insurance Corporation to a liability up to Five Thousand ($5,000.) Dollars for each of the city's various accounts such as the

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[4] Carroll's Kentucky Statutes, Sec. 2903.

"Bank selected annually for current deposits.—The mayor, comptroller and treasurer, and when the offices of comptroller and treasurer shall have ceased to exist, as provided by this act, the mayor and director of finance shall annually select a bank or banks, or banking institutions, which will give the highest rate of interest for the current deposit of the city's funds, and which shall give and maintain a bond, to be approved by said city officials, said bond to be conditioned for the safekeeping and prompt payment of said funds, or any part thereof, when demanded by the treasurer or director of finance, as the case may be."

[5] "The commissioners of the sinking fund shall deposit the funds in their hands as commissioners in some incorporated bank, state or national, located or doing business in said city. The bank selected by the commissioners aforesaid shall give bond with good and sufficient security to secure the said commissioners the payment of all moneys and other things of value deposited by them with such bank."

sinking fund account, the paving fund account, the firemen's pension fund account, etc. The court decided that the sinking fund money was held in trust by the city treasurer for bondholders and judgment creditors. The city was held not to be the owner of the account for the purpose of determining the extent of the F. D. I. C. guarantee.

CONCLUSION

Setoff Will Not Be Permitted Where Preference and Unfair Advantage Results

The ruling in the lower court denying relief was a denial of preference and a denial of the right of the petitioner to secure possession of bonds worth in excess of par in exchange for its depreciated deposit.

Petitioner's reliance for allowance of the writ is based on a claim of conflict with decisions of this Court and rulings by other circuits, the Court of Appeals of Kentucky, and prior rulings by the Court of Appeals for the Sixth Circuit. It is also claimed that there is a departure from the usual course of judicial proceedings and that the case involves important principles.

The entire contention is based on the assumption that the problem of setoff was presented. The cases cited involving actual setoff, however, were cases where there was an attempt to secure a balancing of mutual accounts. Such a case was not presented here and the decisions mentioned by petitioner are not in conflict with the ruling made by the Court of Appeals.

We respectfully submit that the writ of certiorari should be denied.

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